A Creditor Country

GEORGE E. ROBERTS

THE NATIONAL CITY BANK OF NEW YORK

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GEORGE E. ROBERTS
Assistant to the President
The National City Bank
of New York

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The end of the war finds the United States in a much stronger position in world affairs than it was at the beginning, but it finds us with new obligations and responsibilities, some of which are of special concern to you who are members of this organization of investment bankers. Among the most significant of the changes which have occurred is the change of our financial position from that of a debtor nation to that of a creditor nation. Do we comprehend all that this means? We understand, of course, that it means that in our financial relations the balance of payments will be in our favor, but do we know all that this involves, and the policies which it imposes upon us? A people who are creditors to the world must not play a miserly part; they must play a helpful, reciprocal part. A creditor nation which expects to receive its balances regularly in gold will not make the best use of its wealth or remain a leading factor in world affairs.

The United States government, in a little over a year and a half, has loaned to governments associated with it in the war, over \$8,000,000,000, and the Secretary of the Treasury within a few days has asked Congress to authorize additional loans of this character to the amount of \$1,500,000,000. In all, including loans privately made and offerings upon the investment market, we will have an interest charge against Europe on account of these transactions of approximately \$500,000,000 per year. How is this interest going to be paid? I am not raising any question about

the solvency of the debtors. I do not question that these countries will have an amount of new wealth each year which they can spare very much in excess of this interest charge. I have no doubt that the governments will be able to collect into their treasuries, through taxation, an amount ample to meet the interest charges. But how are the payments to be accomplished? I am thinking of the physical difficulty in making payments in another country and in a different money. In the settlement of debts between individuals there are three ways of doing it. They may be paid in cash, they may be paid in trade, by the transfer of property, or you may give your promissory note, which of course is not a final settlement, although it may defer the settlement to a more convenient time.

And settlements between countries are likewise accomplished in these three ways. The claims may be paid in gold, they may be offset with goods, or they may be settled for the time by means of loans or the sales of securities.

Now we know, to begin with, that these interest charges will not be settled in gold, because the total production of gold in the world outside of the United States is less than $400,000,000 per year. And, even if these governments were able to relinquish from their present holdings sufficient gold to make a few payments, the effect of adding gold to our already large reserves would be to raise the level of prices in this country, and maintain prices here above those in the rest of the world, which would place us at a disadvantage with our competitors in world trade. It would make this the best country in the world to sell goods in, and the poorest country in the world to sell goods from. We couldn't afford to take their gold with such results.

And if, instead of shipping gold, these governments should attempt to gather up exchange over the world to the amount of the interest charge, the effect would be to exhaust the supply of dollar exchange everywhere, so that our foreign customers who were buying our goods would be unable to get any exchange with which to make their payments. Dollar exchange would go to such a premium everywhere that it would put a prohibitory tax on our exports. So we don't want attempts to pay the interest in that way.

Well, then, will we take our pay in foreign goods? For the ten years ended with June 30, 1914, the average annual trade balance in favor of the United States on merchandise account was about $500,000,000. That is how we stood on the commodity exchanges before the war. This balance was largely offset, however, by interest and dividend payments on American securities held abroad, by our payments for the use of foreign ships in our commerce, by the expenditures of American tourists abroad, and other incidental items. But since then we have bought back most of the American securities that were held abroad. Do we want to import enough foreign goods to not only cover our former merchandise balance, but the balance on interest account?

Why, our trade conventions and commercial congresses are all talking about reducing our imports and increasing our exports! At Atlantic City last week, at the sessions of that very representative body, the United States Chamber of Commerce, a list was presented of some 470 commodities which heretofore we have been buying abroad, but which hereafter we are going to make at home, and Mr. Schwab told them that we were going to have the greatest merchant fleet in the world, to carry our increasing exports to all

quarters, thus keeping our industries running at top speed.

Now, of course, I am in favor of foreign trade. Over at the City Bank we are doing all we can to encourage people who are qualified to make a study of the export trade. And I like the idea of having our own ships, but I am bothered about this situation. Frankly, I think that in the long run we will have to modify our enthusiasm a little about making everything for ourselves and doing everything for ourselves, and at the same time doing so much more for everybody else. If we are going to have balances in our favor in every important relation with other countries, how are they going to make payment? There is only one possible way in which it can be done. We will have to capitalize our balances and convert them into foreign investments. We are out in the world to stay, for we never can get our belongings home.

Without approaching any controversial phase of the subject, it is certain that at the present time, in view of the world scarcity of goods and of capital, all interests will be served by having us export up to the limit of our capacity. The countries of Europe are going to have too much to do at home to export freely for a time. We have the capacity, but how will would-be buyers make payment? The only way we can sell anything to Europe at this time is by granting credits freely. And when I speak of credits I am not talking about commercial credits. We cannot take part in the reconstruction of Europe on 60 and 90 days' time. The exporters and bankers cannot carry these credits. They would soon be loaded up and out of the business. What kind of a fix would bankers be in to take care of the home situation if they loaned their demand deposits to build houses and equip shops in Europe? We

must create an investment market which will take these securities, and it is up to the investment bankers to do this. The public must take these loans as long term investments.

I repeat that this situation is not because the people of Belgium, France, Italy and other countries are individually unable to make payments. They are able to make them at home, in their own money, but they are unable to overcome the difficulty which attaches to making payment here. There is no medium of payment. They cannot send you farms or buildings or railways or industrial plants, but they can send securities which carry the title to property.

The situation is illustrated by the relations between Canada and the United States during recent months. A party in Canada desiring to make a payment in the United States has had to pay a premium of approximately two per cent. for a draft. The explanation has been that Canada's importations from the United States have been larger than her exportations to this country; our exports to Canada for the fiscal year ended June 30, 1918, amounted to $778,510,000; our imports from Canada in the same time amounted to $321,000,000, and credits had to be created here against which the Canadian banks might draw for their customers who had payments to make in this country. In ordinary times gold would be shipped; that is the regular method, but during the war trade has been so unbalanced that the Canadian government put an embargo on gold exports. It recognized a danger that the gold reserves of the country might be all drained away. Some other method of creating Canadian credits here and of effecting the settlements had to be found.

Canadian exchange in New York may be created by selling securities in New York, by borrowing there

or by shifting credits from some other market, as from London, but where it must be done by these methods, supplementing the ordinary trade credits, somebody must be paid for rendering the service. As the demand for exchange increases the rate rises and the compensation is increased. The compensation which it has been necessary to pay during the past year has been about two per cent. That two per cent. has increased the cost in Canada of importations from the United States and it has also served as a premium on Canadian exports to the United States. Two per cent. may not seem very large, but it would seriously affect profits in many lines of trade; moreover, the exchange charge might easily have been five per cent. or ten per cent., if the trade balance had been larger, but in order to hold the balance down the Canadian Government placed an embargo on the importation of luxury goods.

Thus, it will be seen, that on account of an unbalanced state of trade in favor of the United States in the last year, the neighboring and friendly Government of Canada took two steps to cut down imports from this country. First, it put an embargo upon gold exports from Canada, the normal method of settling balances; and second, it forbade the importation of goods classed as luxuries or non-essentials.

But lest it may be thought that the action of the Canadian Government was unfriendly and extraordinary, let me hasten to add that the United States pursued precisely the same policy, where the trade balances were adverse to it. Because it maintained an embargo on gold, and because there was a trade balance between the United States and Argentina largely in favor of the latter, it has been necessary in this country to pay a premium of about seven per cent. to get a draft on

Buenos Aires, and this charge has increased to this extent the cost of all our importations from Argentina.

For a similar reason it has been necessary to pay as high as fifty per cent. premium for a draft on Spain, and in Italy it has been necessary to pay a premium of one hundred per cent. for a draft on New York. What show would we have to export goods to Italy against such an exchange charge as that? In Paris today it is costing about five per cent. to get a draft on New York and it has been as high as ten per cent. In London a New York draft costs about two per cent., but it has taken constant lending by this country for the last three years to hold it down to that point.

These premiums, or exchange charges, have been due to the fact that payments were running heavily one way and it was difficult to obtain further credits in the creditor country. Contrary to popular opinion it is not necessarily a question of national credit, but mainly of unbalanced trade. If you are in New York and want to convert New York funds into a draft on Madrid you have to find someone who has a bank balance in Madrid which he will transfer to you in exchange for your New York funds.

The position of the bankers who deal in foreign exchange is often misrepresented. They are not responsible for the fluctuations. A banker may borrow abroad temporarily for exchange purposes, but not for an indefinite amount or an indefinite time. In the long run the banker is simply a dealer. He buys and sells on the market, and exchange rates are governed by the trend of payments between countries. If the balance of payments is one way temporarily, during a few months of a year, and certain to be reversed in later months, bankers can and do bridge over the period and the fluctuations in rates are slight, but if the bal-

ance of payments is continuously one way the exchange bankers cannot stand in the gap. No government exchange bank could stand in the gap. There are only two remedies for such a situation: one is to have exchange rates go high enough to force the merchandise trade back into balance, and the other is to have the creditor country balance the account by continually converting its credits into investments.

These conditions are fundamental. If the balance of payments is in favor of the United States, both on merchandise account and interest account, exchange rates will rise as the balances increase until they are prohibitory upon exports, unless we accept settlement in securities. Our new position as a creditor nation will compel us to be a lending nation. If we fail to recognize this condition our export trade will be cut off by the sheer inability of would-be customers to find the means of making payments to us. Exchange rates on this country will penalize our exports.

This situation faces us suddenly, as a result of the war. Great Britain and Germany grew into their great foreign trade gradually, by means of their foreign investments. They developed a body of investors accustomed to put their money into companies doing business abroad. The British or German promoter found the opportunity for an investment, the securities were sold in England or Germany and the money was expended there for equipment or merchandise and the export trade flourished. Great Britain and Germany not only developed their export trade in this manner, but by this exportation of capital they created the great properties which they own all around the world.

In the United States we are now confronted with the question, can we rise promptly to an appreciation of the necessities of our newly attained position? Are

we ready to lend and lend and lend continually and permanently to support and develop our foreign trade? Will our investment market take up the offerings that will have to be made here in order to hold the exchange situation level?

The truth is that we have developed our industries and increased our wealth so far beyond the position of other countries that in the very nature of things it is now to our interest to be a lending nation until the equilibrium is in some degree restored.

The suggestion has been made in this country that the United States should forgive or cancel its loans to Great Britain, France and other allies, on account of the services they have rendered to the world, this country included, in the war. I am not going to discuss the merits or the difficulties of that proposal, and it may be doubted whether the debtor countries would care to have the subject brought under discussion or any such action taken, but it is pertinent to say that from our own standpoint, in view of the present situation in the exchanges, early payments upon either principal or interest are undesirable. We already have more than our share of the world's gold and additions to our stock would be harmful instead of advantageous. Payments in goods upon any such scale as would be required would cause an interference with our established industries, for which the country is unprepared, and which certainly would be vigorously opposed. Other countries have far greater need to import commodities than has the United States. There is no doubt that as a practical proposition the business interests of this country would say, we do not want to be paid in goods, and this means that we must increase the amount of the loans by the amount of the interest, perhaps for years to come—not because the debtors

are unable to pay, but because as a creditor nation we find it to our advantage at this time to increase our investments abroad.

There is a natural equilibrium in economic affairs which in the long run is bound to be maintained. There is an altruism in the economic law which prevents an individual or a nation from absorbing wealth without limit. An individual whose investments have reached the point where the income more than suffices for his own wants, goes on accumulating and reinvesting his surplus, although the gains no longer contribute anything to his personal needs or comfort. It is reserve wealth or surplus wealth to him. Nominally and lawfully it belongs to him; he controls it; but, actually it is in the service of the public.

And so it is advantageous for a country whose stock of wealth is proportionately greater than that of the rest of the world to grant aid to other countries less advanced or temporarily short of working capital. In our economic relations our obligations coincide with our largest and best interests. There is an obligation upon us to assist in restoring industrial order in the devastated regions of Europe, to put these people back into homes and workshops, to supply them with the means to become self-supporting and prosperous again, and it is to our interest to do it because it will give employment to our own industries. Our own interests will be best served by allowing our income from the foreign loans to remain in the possession and service of our debtors. Neither the principal nor the interest will ever be wrung from distressed peoples. When the payments are made it will be done by the natural readjustments in international affairs, and by that time the productive powers of all countries will have so increased that no burden will be felt.

I would like to emphasize, in this connection, what to me is a most suggestive feature of this international situation. We are, I repeat, under constraint by our interests to allow both principal and accruing interest to remain in the debtor countries. Think of just what that means: it means that this capital, instead of being passed over to us, will remain in use in these debtor countries. It will be used to finance their business, to enlarge their industries and give employment to their people. It will contribute to the strength of their banks, it will build up their foreign trade, and if we want to take the narrow view of it, we may say that this capital of ours in their hands will help to strengthen them as competitors of ours in world affairs. And yet it will be to our advantage to do it. We will suffer if we fail to do it. In order to serve our own interests we must serve the common interests, and that principal holds throughout the business world. That Europe shall not pay her debts to us under present conditions is fixed in the very constitution of things, in the framework of economic relations. I doubt if she ever does pay in the sense of sending goods or gold to this country. Not if we remain a creditor nation. We will have interests over there, we will have paper certificates of obligation or perhaps of ownership in properties over there; but if we continue to take interest or dividends in the form of new certificates we will withdraw nothing. A creditor nation, increasing in wealth, is always adding to the holdings of its tin boxes. What difference does it make to the debtor nations so long as they have all the property and all the increment from the property? Generations may come and go, enjoying a constantly increasing stream of products from these properties, and never knowing that they

are in debt. So little do certificates of ownership really count in the distribution of consumable wealth.

To illustrate—let us suppose a case within our own country. Let us suppose that a resident of New York makes an investment in Montana. Montana is not a foreign country, but it is as far away as a foreign country, and economic laws are the same everywhere. We will suppose a resident of New York makes an investment in Montana, in a mining or manufacturing enterprise. The business is successful, but as the owner has all the income he requires for personal expenditures from other sources, he draws nothing from it. All the profits are retained in the business for development purposes. The plant is enlarged; the product is increased. The product has a ready market; it meets a common need; the public is served by the increased production. The payroll grows larger; a town grows up about the works; it grows into a city, with stores, schools, churches, libraries, theatres, street railways, and all the facilities, equipment and conveniences of city life. It is a prosperous, progressive community. Finally, the owner dies, never having drawn a dollar from the Montana property. Query: who has had the benefits of the investment in Montana? You may say that somebody will inherit the property, but that does not alter the principle that so long as the increment is reinvested productively the benefits are running to the public and not to the owner.

An instance quite similar in some respects to this supposed case developed the other day when Capt. Joseph Delamar, whose wealth was largely in western mines, died and left $10,000,000 worth of securities to the endowment funds of Columbia, Harvard and Johns Hopkins universities. That case is closed with the accumulations definitely dedicated to the public.

In the case of a creditor country, of course, individuals receive their incomes from foreign investments, but the aggregate of foreign investments will naturally continue to increase so long as the state of industry and the exchanges makes it mutually advantageous. There is a tendency for investment capital to flow to the places where it is most needed, as there is for commodities to flow to places where they are scarce and in demand. A mutual interest is served. There is a tendency to level conditions throughout countries which are in contact, bringing up those which are behind. The effectiveness, the marginal utility, of capital is greater in a country where capital is relatively scarce. The part which a creditor country plays is not a blood-sucking, exploiting part, as sometimes represented, but a helpful, constructive part, even benevolent in the sense that the immediate benefits are likely to be on the side of the borrowing country. In a free, peaceful state of world affairs, I do not know how one nation can be exploited by another. When I was a boy in the Middle West, it used to be said that that section of this country was exploited by the East, but the development of the West was greatly aided by Eastern capital, and there is more Eastern capital in the West now than ever before. If conditions in Mexico were as favorable to the employment of capital there as on this side of the line, there would be a great flow of capital into Mexico and quick leveling of living conditions there to what they are in this country. And, finally, the development of Mexico, and of her now idle resources would react beneficially upon this country.

The fundamental fact in world relationships and in all economic relationships is this mutuality of interests. Unfortunately, there is only a faint comprehension of it, and, because this is so, we have a world

of rivalries and antagonisms, which naturally break out from time to time in war. The responsibility for war does not lie wholly with the nation which fires the first gun. The spirit of war is developed in mistaken ideas about national interests. If nations believe that their fundamental interests are in conflict, that there is an irreconcilable rivalry and struggle for existence, if people believe that the future of their country or of their children is at stake,—of course they will fight; war is inevitable. Nothing else is to be expected.

I do not like the language of warfare in description of trade rivalries. There are trade rivalries; they are necessary, legitimate, and, if conducted in the proper spirit, stimulating and wholesome. But it is a mistake to emphasize them as though the success of one nation depended upon driving another out of the field. That idea is based upon the assumption that there is only a limited amount of business to be done and never enough for all—an error responsible for infinite mischief.

It is the chief grievance alleged against the labor organizations that they sometimes limit the output, acting upon the theory that there is only a limited amount of work to be done, and that it is to their interest to make it go as far and pay as much in wages as possible. Every such conception of industry and business is fundamentally wrong. There is no limit to the amount of work to be done or the amount of business to be had, because there is no limit to the amount of wealth that may be created from the resources of nature, or to the consumptive demands of the world's population.

Can anyone think in this age that there is danger of general over-production of the commodities of trade? The people of the United States live upon a

level of comfort above that of any other people in the world, and yet the average family in this country lives far below the level of its wants and its commendable aspirations. In this day of free schools, of cheap printing, of democratic ideas, the wants of the people develop faster than their ability to supply them, and hence we have a growing discontent which threatens the very foundations of the social order. The spirit which finds its blind expression in Bolshevism has its inception in the desire for better living conditions, and it is an affront to that spirit—and an affront to common sense—to conduct the international policies of nations upon the theory that the chief danger to be averted is that of over-production. Such an argument amounts to a confession of ineffectiveness or non-achievement in the industrial management of the world, and affords a basis for challenging the existing order.

But it is one thing to be critical and another thing to be constructive, and the critics of the existing order, where they get a chance, display a greater incompetency. The condition of the masses will never be improved by paralyzing industry in efforts to divide the existing stock of wealth. The existing stock in itself is of small importance; it is the constant and efficient employment of all the agencies of production, and the regular and increasing flow of goods to the market, which concerns the public. The problem of society everywhere is to organize more effectively—to co-ordinate, integrate and balance—production in all branches to obtain the greatest possible output of the things which minister to the common comfort and welfare, and to secure by exchange of products and services their widespread distribution and consumption. This is the great appeal to the enlightened and constructive forces of the world.

The United States, as a creditor nation, by the very logic of its position and for the maintenance of its leadership, will be obliged to use its strength for the upbuilding of other countries. It has the opportunity, the resources, the industrial equipment and organization to play a great part in the reconstruction and progress of the world. The only question is, how is the world to pay for the things it would be glad to buy? We can have any amount of business from Russia, from Asia, from South America and from Europe, upon condition that we finance the purchases, giving them a chance to pay out of the benefits which are created.

When one sees the opportunities that are waiting for capital everywhere, and of the benefits that would result if they could be improved, he is prompted to think that this country ought to be willing to go on siege rations, with meat days, bread cards and milk tickets, and voluntarily economize and devote its savings and its industrial equipment to increasing the productive capacity of the world, and thus ameliorating conditions in this great emergency.

No group of business men in this country is more directly interested in this situation than the Investment Bankers. It is your business to popularize the fundamental virtues of thrift and economy, to teach the social service that is performed in saving for investment, and to gather up the capital which is required for industrial development. There is no adequate comprehension in the public mind of the part which Capital plays in social progress, or of the obligations of our new position. It is for you to assume leadership in a campaign of education.

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